

March 13, 2001

Mr. David Ikari., Chief  
Dairy Marketing  
California Department of Food and Agriculture  
1220 N Street  
Sacramento, California 95814

Dear Mr. Ikari:

Land O' Lakes in Tulare California petitions the Department of Food and Agriculture for a hearing to consider changing the make allowance for Class 4b milk because of the energy crisis and the increased rates for natural gas and electricity. We understand that California Dairy Inc. has petitioned the Department with respect to Class 4a for adjustments in the butter and powder make allowances. Land O' Lakes Inc. supports that petition.

One of the important reasons for adjusting the make allowance in the Class 4b formula is because of the energy crisis and the increased rates for natural gas and electricity. Information obtained from the California Department of Food and Agriculture reveals that the price of natural gas for the Land O' Lakes operation has more than tripled since the last make allowance adjustment was made for cheese. In addition, our invoices indicate that the cost of electricity has increased by at least 20 percent. We are recommending that the make allowance for cheese be increased to reflect the increased cost for manufacturing this product.

Since the last make allowance change, the cost of energy grew from \$.295 per therm to \$.90 per therm for cheese plants in California. Based upon this therm cost increase, the Land O Lakes cost for natural gas would increase the cost of making cheese by \$.0168 per pound. The cost of electrical energy increased by 20 percent which means that the electrical energy component increase the cost of making cheese in Land O' Lakes plants by \$.00148 per pound. Land O' Lakes recommends that the changes in utility costs be indexed and that the make allowance for butter, powder and cheese would automatically increase or decrease with the changes in the utility costs. The changes in utility costs have been extremely volatile and it is for these reasons that we recommend an indexing procedure. As utility costs increase the make allowances for butter, powder and cheese would increase; but, as utility costs decrease, the make allowances for butter, powder and cheese would automatically decrease. We believe that the concept of indexing utility costs is fair both to processors as well as producers. We understand that California Dairy Inc. has also recommended the use of indexing the make allowance to utility cost changes.

Based upon utility cost changes we recommend the following adjustment in the cheese make allowance:

Cheese	
Natural gas cost increase	\$ .0168
Electrical cost increase	\$ .00148
Total	\$ .01828

The current make allowance cheese is \$.169 per pound. This means that the new make allowance cheese would be \$.187 per pound.

The recent cost study of manufacturing plants in California by the California Department of Food and Agriculture showed that the average processing costs for cheese plants was \$.1852, the weighted average cost was \$.1753 and the median was \$.1801. This was before the recent cost increases for electricity and natural gas. A make allowance of \$.187 certainly does not appear to be unreasonable. In fact, it seems to be on the low side.

Section 300.00. Subparagraph (E) will be amended as follows:

- (1) The Cheese hundredweight price shall be the price per hundredweight computed by the sum of the following:
  - (a) The price per hundredweight computed by using the simple average of the 40 pound block price quotations for the last significant transaction for Cheddar cheese at the Chicago Mercantile Exchange as reported weekly in the Dairy Market News published by the United States Department of Agriculture, less a marketing adjustment of one and two-tenths (\$.012), less a Cheddar cheese manufacturing cost allowance of eighteen and seven tenths (\$.187), all multiplied by a yield factor of ten (10).

The remainder of the language would remain as it is.

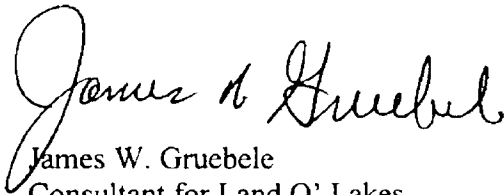
The energy situation had reached catastrophic proportions and California is still extremely short of electrical power. There could be rolling blackouts, particularly during the summer months. Land O' Lakes has been advised to voluntarily reduce power consumption during periods when the power would have been interrupted. The emergency item passed by the Puc on January 29, 2001 discontinued the mandatory interruptions of power for those firms who participated in this program. The simple fact is that California does not have adequate production of electrical energy. Not only that, the supply of natural gas

is very limited. We are recommending an immediate increase in the make allowance for cheese to reflect the increased energy costs as well as other costs. Land O' Lakes lost about \$500,000 because of interruptions in power. The reason was that the entire operation was much less efficient when power was shut off. The requested make allowance for cheese does not make up for that loss.

About 70 percent of the milk in California has to be manufactured into butter, powder and cheese. There is no where else to go. The producers need these manufacturing facilities. The alternative is to dump the milk. The cost of disposing of milk is very costly because of environmental restrictions and, the losses to individual producers would be devastating. It is imperative that there is an adequate manufacturing allowance for cheese so that these firms are able to process these very important products. It is also imperative that the cheese manufacturing cost allowances are large enough to continue to encourage further expansion of manufacturing capacity of cheese. This additional capacity is essential because of the continued growth in milk production in California.

Dairy Farmers of America supports our petition for a make allowance adjustment for cheese. We support the petition by California Dairy Inc. to adjust the make allowances for butter and powder. We believe that the increases in the make allowances recommended by California Dairy Inc. are warranted.

Sincerely,

A handwritten signature in cursive script that reads "James W. Gruebele". The signature is written in dark ink and is positioned above the printed name and title.

James W. Gruebele  
Consultant for Land O' Lakes